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UNITED STATES BANKRUPTCY COURT  
FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re:	]	Case No. 92-57143-ASW
	]	
Los Gatos Lodge, Inc.	]	Chapter 7
	]	
Debtor	]	
	]	
In re:	]	Case No. 92-57303-ASW
	]	
Norman and Jean McFate,	]	Chapter 7
	]	
Debtors	]	
	]	

MEMORANDUM DECISION  
PERMITTING RECOVERY UNDER §506(c) IN PART  
AND DENYING RECOVERY UNDER §506(c) IN PART

Before the Court is a motion in each of the above-numbered Chapter 7 cases, filed by Mohammed Poonja ("Poonja"), trustee in the case of Los Gatos Lodge, Inc. ("Corporation"). By such motions, Poonja seeks to surcharge collateral of Sacramento Savings Bank ("Bank"), predecessor of Alleghany Properties, Inc.

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1 ("Alleghany"), pursuant to 11 U.S.C.<sup>1</sup> §506(c).

2 Poonja is represented by Seymour J. Abrahams, Esq. and  
3 Alleghany is represented by Jeffrey B. Gardner, Esq. of Saxon,  
4 Barry, Gardner & Kincannon. The matter has been briefed and  
5 argued, and this Memorandum Decision constitutes the Court's  
6 findings of fact and conclusions of law pursuant to Rule 7052 of  
7 the Federal Rules of Bankruptcy Procedure ("FRBP").

8 I.

9 FACTS

10 The facts of this matter are largely undisputed.

11 Corporation is the Debtor in Chapter 7 Case No. 92-57143, and  
12 Norman and Jean McFate ("McFates") are the Debtors in Chapter 7  
13 Case No. 92-57303. McFates (or their family trust) owned the  
14 shares of Corporation; McFates (or their family trust) also owned  
15 the real property upon which Corporation's business was located,  
16 and leased the real property to Corporation. Corporation owned a  
17 building on the real property, where Corporation operated a  
18 business consisting of a motel, a restaurant, and a cocktail  
19 lounge.

20 Corporation filed a Chapter 11 petition on October 13, 1992  
21 and McFates filed one on October 20, 1992. Each bankruptcy debtor  
22

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23  
24 <sup>1</sup> These cases were filed prior to October 22, 1994, the effective  
25 date of the amendments to Title 11, United States Code ("Bankruptcy Code")  
26 that were enacted in 1994; unless otherwise noted, all statutory references  
27 are to Title 11 as it provided prior to such amendments.

1 operated as a debtor-in-possession until June 9, 1993, when a  
Chapter 11 trustee was appointed in each case: Poonja was  
2 appointed in Corporation's case and John Richardson ("Richardson")  
3 was appointed in McFates' case. Corporation's case was converted  
4 to Chapter 7 on November 26, 1993 and Poonja was appointed Chapter  
5 7 trustee; McFates' case was converted to Chapter 7 on December  
6 17, 1993 and Richardson was appointed Chapter 7 trustee.

7 Bank was owed over \$6.5 million by McFates, which debt was  
8 secured by a first deed of trust on the real property that was  
9 owned by McFates (or their family trust) and leased to  
10 Corporation. Bank claimed that such debt of McFates was also  
11 secured by a security interest in personal property of the motel  
12 business that Corporation operated upon the real property, and in  
13 the rents generated by the motel; the rents were subject to a  
14 senior security interest held by Comerica Bank and the Court ruled  
15 during the Chapter 11 phase of the cases that Bank held no  
16 security interest in rents.

17 While the cases were in Chapter 11, Bank sought stay relief  
18 to foreclose and such relief was granted in June 1993 with a stay  
19 until September 2, 1993. Bank foreclosed on the real property  
20 October 7, 1993 and bid \$6,570,903.47, which was \$200,000 less  
21 than Bank was owed. Bank then foreclosed under its claimed  
22 personal property security interest and bid \$200,000 for that  
23 property.

24 At the request of another creditor, Poonja was appointed  
25 Chapter 11 trustee in Corporation's case at approximately the same  
26 time that stay relief was granted to Bank. At the hearing on  
27

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1 appointment of a trustee, Bank asked that a single trustee be  
2 appointed to handle both Corporation's estate and McFates' estate,  
3 but the office of the United States Trustee appointed separate  
4 trustees. As trustee, Poonja operated Corporation's business for  
5 approximately four months, until the foreclosures and (by  
6 agreement with Bank) for six days after the foreclosure, until  
7 Bank took possession. Bank never expressly consented to Poonja  
8 surcharging Bank's collateral under §506(c), nor did Bank tell  
9 Poonja during his operation of the business that Bank would oppose  
10 such a surcharge.

11 Poonja took the position that Bank's personal property  
12 security interest did not extend to property owned by Corporation  
13 and applied only to property owned by McFates, who were Bank's  
14 debtors and who had granted the security interest. That  
15 controversy was compromised in May 1994 by a Court-approved  
16 settlement ("Settlement"), under which: 1) Bank paid Poonja  
17 \$138,054.39 (allocated by Allegheny as: \$3,100 for a van; \$9,000  
18 for the business' liquor license; \$17,454.39 for inventory and  
19 cash on hand; \$28,500 for the business' name and goodwill; and  
20 \$80,000 for furnishings, fixtures, and equipment); 2) Poonja  
21 agreed to assert no further interest in the subject personal  
22 property; 3) the secured claim that Bank had filed in  
23 Corporation's case was disallowed; and 4) Poonja turned over  
24 \$21,000 of the amount paid by Bank to Comerica, which had asserted  
25 a senior security interest in some of the same property that Bank  
26 claimed as collateral. The Settlement expressly provides that the  
27 parties' respective rights under §506(c) are not affected by the

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1 Settlement and are reserved.

2 Poonja claims to have devoted \$80,861.37 worth of time and  
3 money to operating Corporation's business, and has requested  
4 allowance of a Chapter 11 administrative expense claim in McFates'  
5 case for that amount. Poonja has received in response a letter  
6 from counsel for Richardson, refusing to pay such claim and saying  
7 that Poonja should pursue Bank under §506(c) because it was Bank  
8 that benefitted from Poonja's efforts rather than McFates' estate,  
9 and Richardson is not going to pursue Bank under §506(c) on behalf  
10 of McFates' estate.

11 II.

12 LEGAL ISSUES

13 Poonja seeks to recover from Bank's successor Alleghany the  
14 sum of \$80,861.37, alleged to be the value of Poonja's services  
15 and expenditures devoted to preserve Bank's collateral, which  
16 preservation is alleged to have benefitted Bank to an extent  
17 exceeding such amount; he also seeks attorney's fees (in an amount  
18 to be determined) incurred to pursue such recovery. Poonja is  
19 proceeding under §506(c), which provides:

20 The trustee may recover from property securing  
21 an allowed secured claim the reasonable,  
22 necessary costs and expenses of preserving, or  
23 disposing of, such property to the extent of  
any benefit to the holder of such claim.

24 Alleghany opposes, on the following bases:

25 A/ Relief under §506(c) must be sought by means of an  
26 adversary proceeding.

27 B/ Poonja lacks standing as trustee of Corporation's

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1 estate, since Bank is not a secured creditor of that estate and  
2 §506(c) permits recovery only from "property securing an allowed  
3 secured claim".

4 C/ Poonja lacks standing as an administrative creditor  
5 of McFates' estate because he does not hold an allowed  
6 administrative claim in that case.

7 D/ Poonja's services did not benefit Bank and §506(c)  
8 permits recovery only "to the extent of any benefit to the holder  
9 of" an allowed claim secured by the property sought to be  
10 surcharged.

11 E/ Poonja's charges are not reasonable and/or  
12 necessary.

#### 13 A. Requirement of Adversary Proceeding

14 Alleghany correctly points out that FRBP 7001(1) requires an  
15 adversary proceeding "to recover money or property", with certain  
16 exceptions not relevant here.

17 Poonja argues that everything is before the Court now and no  
18 purpose would be served by requiring him to commence an adversary  
19 proceeding and file the same pleadings in that matter that have  
20 already been filed in these two bankruptcy cases. Poonja notes  
21 that In re Palomar Truck Corp., 951 F.2d 229 (9th Cir. 1991),  
22 cert. denied sub nom General Electric Capital Corp. v. North  
23 County Jeep & Renault, Inc., 506 U.S. 821, 113 S.Ct. 71 (1992)  
24 ("Palomar") and "many" other cases concerning §506(c) have been  
25 handled as contested matters rather than as adversary proceedings.  
26 That is true (at least as to Palomar), but Palomar is

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1 distinguishable, since there is no indication in that case of any  
2 objection to the motion procedure, whereas Alleghany does object  
3 here.

4 Poonja correctly points out that Alleghany has shown no  
5 prejudice thus far from the use of motion procedure rather than of  
6 an adversary proceeding, and cites In re Orfa, 170 B.R. 257  
7 (E.D.Pa. 1994) ("Orfa") (a case also cited by Alleghany), in which  
8 a district court declined to "elevate form over substance" by  
9 requiring an adversary proceeding where no prejudice was shown to  
10 have resulted from treating the dispute as a contested matter.  
11 Orfa cites with approval In re Command Services Corp., 102 B.R.  
12 905, 908-909 (Bkrtcy. N.D.N.Y. 1989), which in turn cites  
13 extensive authority supporting Poonja's position:

14 ... courts have concluded that where the  
15 rights of the affected parties have been  
16 adequately presented so that no prejudice has  
17 arisen, form will not be elevated over  
18 substance and the matter will be allowed to  
19 proceed on the merits as originally filed.  
20 See, e.g., In re Szostek, 93 B.R. 399, 403 n.  
21 6 (Bankr.E.D.Pa.1988) (Bankr.R. 7001(5):  
22 revocation of confirmation order); In re  
23 Morysville Body Works, Inc., 89 B.R. 440,  
24 441-442 (Bankr.E.D.  
25 Pa.1988) (Bankr.R. 7001(7): debtor's petition  
26 to stay IRS in collecting responsible penalty  
27 tax from its principal); In re Roberts  
28 Hardware, Co., No. 87-01800, slip op. at 4 n.  
3, --- B.R. ---, ---, n. 3 (Bankr.N.D.N.Y.  
Apr. 11, 1988) (Bankr.  
R. 7001(1): action to recover property); In re  
Data Entry Serv. Corp., 81 B.R. 467, 468 n. 1  
(Bankr.N.D.Ill.1988) (Bankr.R. 7001(2): lien  
determination and distribution order); In re  
McClain Airlines, Inc., 80 B.R. 175 (Bankr.D.  
Ariz.1987) (defense under Code § 541 to  
debtor's motion to assume lease does not  
require opponent to file adversary complaint);  
In re Stern, 70 B.R. 472, 473 n. 1  
(Bankr.E.D.Pa.1987) (Bankr.R. 7001(4):

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1 revocation of discharge); In re Wallman, 71  
B.R. 125, 126 n. 1 (Bankr.D.S.D. 1987)  
(Bankr.R. 7001(2): debtor's motion for  
2 contempt and sanctions due to nonexistence of  
lien); Doran v. Treiling (In re Treiling), 21  
B.R. 940, 941 n. 1 (Bankr.E.D.N.Y.1982)  
3 (Bankr.R. 7001(1): proceeding to recover  
money); cf. Smith v. New York State Higher  
4 Education Serv. Corp. (In re Smith), No.  
83-01317, slip op. at 8-9, 11, --- B.R. ----,  
5 ---- - ----, ---- (Bankr.N.D.N.Y. Mar. 21,  
1988) (noting operative verb in Bankr.R. 7001  
6 is "may", in contrast to "shall" in Bankr.R.  
9014). Accord In re Banks, 94 B.R. 772 (Bankr.  
7 M.D.Fla.1989) (motion of Chapter 11 debtor's  
counsel for recog- nition and approval of  
8 charging lien). ... Indeed, the notice  
pleading of the Federal Rules and the mandate  
9 of Rule 8(f) of the Federal Rules of Civil  
Procedure ("Fed.R.Civ.P."), incorporated by  
10 Bank. R. 7008(a), that "[a]ll pleadings shall  
be so construed as to do substantial justice"  
11 support this liberal interpretation by a court  
of equity. ... Bankr.R. 9005 is also germane,  
12 applying as it does Fed.R.Civ.P. 61 which  
provides, in part, that "[t]he court at every  
13 stage of the proceeding must disregard any  
error or defect in the proceeding which does  
14 not affect the substantial rights of the  
parties." See In re Ross & Hurney Paving,  
15 Inc., supra, 51 B.R. at 375.

16 Alleghany has not cited, nor has this Court located, any  
17 binding precedent that prohibits use of motion procedure for  
18 claims under §506(c). FRBP 9014 provides that the Court "may at  
19 any stage in a particular matter" direct that any of the rules  
20 governing adversary proceedings are to apply to contested matters  
21 such as motions. Under the circumstances of this case,  
22 Alleghany's rights will be fully protected if Part VII of the FRBP  
23 governing adversary proceedings is applied to these motions with  
24 respect to any future proceedings.

25  
26 Poonja may proceed under §506(c) by means of motion, with the  
27 rules governing adversary proceedings made applicable

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1 prospectively.

2 B. Poonja's Standing in Corporation's Case

3 Alleghany argues that Poonja lacks standing to assert §506(c)  
4 against Alleghany in Corporation's case because Alleghany's  
5 predecessor Bank did not hold an allowed secured claim in  
6 Corporation's case and §506(c) only applies to recovery from  
7 "property securing an allowed secured claim". Alleghany notes  
8 that Poonja objected to the secured claim filed by Bank in  
9 Corporation's case, which secured claim was disallowed pursuant to  
10 the Settlement.

11 Poonja points out that Rule 408 of the Federal Rules of  
12 Evidence ("FRE") prohibits evidence of a settlement to prove the  
13 validity or amount of a claim so, to any extent that the  
14 Settlement may have determined whether Bank was a secured creditor  
15 in Corporation's case, the Settlement should not be admitted as  
16 evidence to establish that fact now. Poonja is correct since,  
17 unlike a judicial decision, a settlement does not determine the  
18 truth of any disputed fact, it merely acts prospectively to give  
19 effect to a bargain; these parties' agreement to treat each other  
20 in certain ways does not mean that Bank's claim was not (or was)  
21 actually secured. Poonja also notes that the Settlement expressly  
22 reserves issues concerning the parties' respective rights under  
23 §506(c), so that such rights cannot now be affected by the fact  
24 that the Settlement exists, nor by the provisions or operation of  
25 the Settlement. The Court agrees with Poonja's position on that  
26 point since, to do otherwise would be contrary to the parties'  
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1 agreement that their §506(c) rights would remain intact despite  
the Settlement.

2 Poonja argues that Bank was a secured creditor of  
3 Corporation's estate at the time Poonja performed the subject  
4 services (June through October 1993) and lost that status only by  
5 virtue of the Settlement (May 1994), which occurred after Poonja  
6 had provided Bank with the benefit of his work in operating the  
7 business until Bank foreclosed and took possession. Under the  
8 Settlement, Bank acquired from Corporation's estate title to  
9 personal property that Bank had not attempted to foreclose upon  
10 (items such as the van and the liquor license, which were  
11 indisputably not encompassed within Bank's security interest), and  
12 also was relieved of a cloud on title to such personal property as  
13 Bank had purported to foreclose upon under a security interest  
14 that Poonja claimed was defective. Once the Settlement was  
15 completed, Bank ceased to be a secured creditor of Corporation's  
16 estate but, prior to that time, Bank was a secured creditor of  
17 Corporation's estate because there had been no judicial  
18 determination that the security interest asserted by Bank was not  
19 valid. Further (although Poonja does not make this point), §502  
20 provides that a claim is deemed allowed until objected to and the  
21 secured claim filed by Bank was only disallowed as part of the  
22 Settlement, after Poonja's services had been provided. Alleghany  
23 cites no facts or law under which Bank's loss of secured status at  
24 the time of the Settlement in May 1994 should be given retroactive  
25

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1 effect,<sup>2</sup> such that Bank should be considered to have been an  
unsecured creditor at the time Poonja was rendering services  
2 during the latter half of 1993. Poonja is correct that Bank was  
3 the holder of an allowed secured claim in Corporation's case at  
4 the time Poonja rendered the services for which he now seeks to  
5 charge Alleghany.

6 Poonja argues that the requirement of secured creditor status  
7 contained in §506(c) should apply to the creditor's status at the  
8 time the creditor's collateral is benefitted, not to the  
9 creditor's status at some later time after the benefit has already  
10 been conferred -- Alleghany appears to argue the opposite  
11 position, although that is not entirely clear. Poonja cites no  
12 authority for his proposition, nor has this Court located anything  
13 on point, but the opposite approach would render the statute  
14 useless in many (perhaps most) situations. Adopting a position  
15 contrary to that taken by Poonja would mean that §506(c) could  
16 never be used after a secured creditor forecloses because a  
17 secured creditor that has foreclosed upon its collateral is  
18 necessarily left with only an unsecured deficiency claim against  
19 the estate; it would be nonsensical to say that one who preserves  
20 collateral pre-foreclosure cannot use §506(c) post-foreclosure,  
21 merely because the creditor who was secured by the collateral pre-  
22 foreclosure (during the period of preservation) is no longer  
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25 <sup>2</sup> This is not a situation where a court found in a contested  
26 proceeding that no security interest ever existed, and this Court does  
27 not reach the issue of what the result would be under such facts.

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1 secured post-foreclosure. Similarly, whenever a trustee or  
2 debtor-in-possession sells a secured creditor's collateral and  
3 pays the creditor in full from proceeds, the creditor thereupon  
4 ceases to be a creditor of the estate; if the relevant time for  
5 secured status was something other than the time at which the  
6 collateral was benefitted, the seller could not, post-payoff, look  
7 to the former creditor to recover expenses of sale and/or of  
8 preserving the collateral pending sale because the former creditor  
9 would then no longer be a secured creditor, having been paid in  
10 full.

11 Alleghany also argues that Bank was unsecured because Bank's  
12 claimed collateral was subject to a senior lien held by Comerica  
13 for \$553,000, which was far more than the value of Bank's claimed  
14 collateral, so that Bank was undersecured to the point of being  
15 completely unsecured. Poonja responds that this is not a case  
16 with a "massive" senior lien that absorbs all value and leaves a  
17 junior lienholder such as Bank effectively unsecured, because only  
18 part of Bank's claimed collateral was subject to a senior lien;  
19 Poonja correctly points out that Comerica's documents show its  
20 security interest to be limited to pre-petition accounts  
21 receivable and some inventory (such as food and beverage supplies,  
22 linens, and janitorial supplies), the value of which Poonja  
23 contends was not great and was consistent with the \$21,000 that  
24 Comerica accepted under the Settlement. Alleghany does not argue  
25 that Comerica's security interest served to encumber all of the  
26 collateral claimed by Bank and the amount of the debt claimed by  
27 Comerica is irrelevant with respect to the extent of Comerica's

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1 security interest.

2 Poonja has standing to proceed under §506(c) in Corporation's  
3 case.

4 C. Standing in McFates' Case

5 Poonja contends that, if he were found to lack standing to  
6 assert §506(c) in Corporation's case, he would nevertheless have  
7 such standing in McFates' case. Alleghany argues that Poonja  
8 lacks standing to assert §506(c) in McFates' case because §506(c)  
9 is only available to the trustee of that estate or, perhaps, to  
10 the holders of allowed administrative claims against that estate,  
11 and Poonja is neither.

12 Poonja relies upon Palomar, a case that Alleghany contends  
13 takes an unduly "expansive" view of §506(c) and was wrongly  
14 decided. In Palomar, the holder of an allowed administrative  
15 claim proceeded under §506(c) when the Chapter 11 trustee did not  
16 make use of the statute himself and did not object to the creditor  
17 making use of it. The Ninth Circuit noted a three-way split in  
18 authority as to whether §506(c) was available for use by anyone  
19 other than a trustee or Chapter 11 debtor-in-possession, and found  
20 (at 232) that "no compelling policies are served by a restrictive  
21 reading of §506(c) in the circumstances of this case"; the Court  
22 also noted (id.) that, if somebody did not make use of §506(c),  
23 the result would be a "windfall" to the secured creditor whose  
24 collateral was enhanced by the administrative creditor. Alleghany  
25 argues that United States v. Ron Pair Enterprises, 489 U.S. 235,  
26 109 S.Ct. 1026 (1989) ("Ron Pair") calls for statutory  
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1 interpretation based on "plain meaning" and §506(c) expressly  
2 provides for recovery by a "trustee", so the Ninth Circuit should  
3 not have permitted anyone other than a trustee to use it. Poonja  
4 points out that Palomar was decided in 1991, two years after Ron  
5 Pair, so the Ninth Circuit must have been aware of Ron Pair in  
6 making the decision that it did. In any event, however much  
7 Alleghany may disagree with Palomar, the fact remains (as Poonja  
8 notes) that the case has not been overturned and remains binding  
9 upon this Court.

10 Alleghany argues that, even if Palomar is applied here, it  
11 does not assist Poonja, since the non-trustee party permitted to  
12 make use of §506(c) in that case was an administrative creditor  
13 and Poonja does not hold an allowed administrative claim in  
14 McFates' case. Poonja points out that Alleghany cites no  
15 authority for the proposition that a non-trustee using §506(c)  
16 must be an administrative creditor, simply because that is what  
17 the non-trustee party in Palomar happened to be; Poonja argues  
18 that the rationale of Palomar was to avoid a "windfall" to a  
19 secured creditor who benefitted from a non-trustee's efforts, and  
20 such rationale would be defeated by denying relief to Poonja  
21 solely because he may not hold an allowed administrative claim  
22 against McFates' estate. This Court agrees with Poonja that the  
23 rationale of Palomar does not depend upon whether the non-trustee  
24 party seeking to use §506(c) holds an allowed administrative claim  
25 -- the stated goal of Palomar was to avoid windfalls to secured  
26 creditors who are benefitted by the services of others (whether  
27 those others be trustees, administrative creditors, or some

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1 different type of party in interest) and there is no apparent  
2 reason for limiting the holding of that case to administrative  
3 creditors as opposed to some other kind of non-  
4 trustee party. One of the three schools of thought discussed by  
5 Palomar holds that a non-trustee party can make use of §506(c)  
6 only when the trustee has refused to do so, and that is the case  
7 here, where counsel for McFates' trustee Richardson has stated  
8 that Richardson will not make use of §506(c).

9 Pursuant to Palomar, Poonja has standing to proceed under  
10 §506(c) in McFates' case.

#### 11 D. Benefit

12 The Ninth Circuit has held that

13 [T]o satisfy the benefit test of section  
14 506(c), [the movant] must establish in  
15 quantifiable terms that it expended funds  
16 directly to protect and preserve the  
17 collateral. [Citations omitted]. [The  
18 movant's] recovery, however, is limited to the  
19 extent that the secured creditor benefited  
20 from the services. [Citation omitted].

21 In re Cascade Hydraulics and Utility Service, Inc., 815 F.2d 546,  
22 548 (9th Cir. 1987).

23 Alleghany argues that Poonja's services in operating  
24 Corporation's business did not benefit Bank, or at least not to  
25 the extent of more than the \$138,054.39 that Bank paid Poonja  
26 under the Settlement, and that Poonja's operation of the business  
27 was for the purpose of benefitting Corporation's estate and did  
28 benefit that estate.

Poonja contends that, when he was appointed Chapter 11

1 trustee, Corporation had no prospect of reorganization, because:  
Bank had received relief to foreclose in three months; the lease  
2 to the real property upon which Corporation's business was located  
3 had been deemed rejected when not assumed within sixty days post-  
4 petition as required by §365, and Corporation owed "many months"  
5 of unpaid rent; tangible assets were of "limited value"; gross  
6 revenues for that year were \$2,340,000 with anticipated net  
7 earnings of \$112,313, without accounting for monthly rent of  
8 \$72,000 (\$864,000 per year); Corporation had "serious" problems  
9 with its management company and faced charges of unfair labor  
10 practices and illegal activity in the lounge; "very substantial"  
11 deferred maintenance required attention (including termite  
12 fumigation) and one wing of the motel could not be rented due to  
13 its poor condition. Poonja claims that the only reason he  
14 undertook operation of the business was to preserve its going-  
15 concern value pending Bank's upcoming foreclosure, in case the  
16 trustee in McFates' case were able to prevent foreclosure by sale  
17 or refinance. However, foreclosure did occur and Bank bid  
18 \$200,000 for the personal property of Corporation in which Bank  
19 asserted a security interest. Poonja points out that, had he not  
20 kept the business operating until Bank foreclosed, Bank would have  
21 taken over only a vacant building furnished and equipped as a  
22 motel/restaurant/lounge that had been closed for four months,  
23 which interruption would have created such problems as: a need to  
24 hire and train new employees; a loss of advance reservations; a  
25 "very substantial" loss of business from travel agents and  
26 corporate travel managers, whose patronage would be transferred  
27

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1 elsewhere after the closing and would have to be solicited again,  
2 if it could be recaptured at all; a loss of established customers  
3 for the restaurant and lounge, who would find other facilities  
4 during the hiatus and might not return; risks of theft and  
5 vandalism, and the expense of preventive attempts such as fencing  
6 and security services; the possible necessity of conforming to  
7 local building codes as a prerequisite of reopening; and a "great  
8 reduction" in resale value compared to the value of a functioning  
9 business operation. Alleghany notes that Poonja's point about the  
10 possibility of Bank having to comply with current building codes  
11 is "speculative", but does not seriously contradict the rest of  
12 Poonja's allegations. Poonja has been on this Court's panel of  
13 Chapter 7 trustees for many years, is an experienced Chapter 11  
14 trustee and examiner, and has served as a receiver in State Court  
15 matters; he is well qualified to state reliable opinions as to the  
16 difference between taking over a business such as that here in the  
17 form of a going concern, and taking over such a business after it  
18 has been closed for four months. Poonja has demonstrated that the  
19 value of Bank's collateral was preserved by his operation of the  
20 business pending foreclosure.

21 Poonja does not attempt to compare in dollar amounts the  
22 value that Bank's collateral would have had if the business had  
23 not been operated with the value that Bank's collateral did  
24 ultimately have, other than to contend that the collateral's value  
25 would have been depressed had the business closed, and that Bank  
26 bid \$200,000 at foreclosure for the personal property in which  
27 Bank asserted a security interest. Alleghany does not attempt to

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1 show that the value of its collateral declined during Poonja's  
operation. Poonja has established that Bank's collateral was  
2 worth at least the amount that Bank bid for it at foreclosure  
3 (i.e., \$200,000).

4 Alleghany argues that Bank paid \$138,054.39 under the  
5 Settlement to buy the subject personal property from Corporation's  
6 estate, and that the price set by the Settlement should be  
7 considered to represent any value attributable to Poonja's  
8 services (which amount has already been paid in full). Poonja  
9 argues that evidence of the Settlement cannot be used to show the  
10 value of the personal property because FRE 408 forbids use of  
11 settlements to prove the amount of a claim, and also points out  
12 that the Settlement expressly provides for §506(c) rights to be  
13 unaffected by the Settlement. As discussed below, the price paid  
14 by Bank under the Settlement appears to have been based on many  
15 factors other than the value of the personal property but,  
16 whatever that price may have represented, the plain language of  
17 the Settlement makes clear that the price was not compensation as  
18 con- templated by §506(c). The Settlement's provision that the  
19 parties' rights under §506(c) are to remain unaffected is  
20 completely in- consistent with Alleghany's position that the  
21 amount called for by the Settlement should determine an issue  
22 raised by §506(c), i.e., the value of Bank's collateral.

23  
24 Poonja contends that, if the price in the Settlement is to be  
25 considered, the "controlling factors" in arriving at that price  
26 must also be taken into account, and are as follows: that Bank  
27 had "a very strong claim" that Bank already owned most of the

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1 personal property by virtue of having bid \$200,000 for it in  
2 foreclosure, whereas Poonja had a "technical" argument against the  
3 validity of Bank's security interest; that it would be expensive  
4 for Poonja to remove from the premises such things as air  
5 conditioners, stoves, beds, dressers, etc. and their market value  
6 once removed would be "negligible", whereas it would be expensive  
7 for Bank to install replacement items for whatever Poonja removed;  
8 and that Bank wanted to avoid delay in using the business' liquor  
9 license. Poonja points out that Bank was the party allocating the  
10 amount paid under the Settlement, and Poonja considers the  
11 allocations to be "low" under normal circumstances (e.g., \$30,000  
12 for good will and signs of a motel/restaurant/lounge is low, even  
13 for a business being sold in bankruptcy). This Court concludes  
14 that the facts surrounding creation of the Settlement show that it  
15 was intended by the parties to be just that, a settlement,  
16 designed to compromise a controversy as to whether Bank held a  
17 valid security interest in personal property that Bank wished to  
18 own. Bank had just bid \$200,000 to acquire the property by  
19 foreclosure, only to face Poonja's "technical" challenge that Bank  
20 had no security interest to foreclose; even though it might not be  
21 cost effective for Poonja to remove the property from the  
22 building, it would be time-consuming and costly for Bank to  
23 replace the property if Poonja did remove it -- further,  
24 Corporation's estate held title to a van and a liquor license that  
25 Bank wanted soon and those were indisputably not subject to Bank's  
26 claimed security interest, so Poonja's control of those items gave  
27 him some leverage with respect to the other items. The position

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1 of each party had strong points and weak points, and litigation  
2 would have entailed risk, delay, and expense for both -- those are  
3 factors typically found in compromises, and compromise is what  
4 occurred in this case. Bank agreed to pay \$1,300 to buy the van  
5 and \$9,000 to buy the liquor license, plus \$125,954.39 to settle  
6 the dispute over the validity of the security interest that Bank  
7 claimed in the other items. The gravamen of the Settlement is not  
8 a purchase of Bank's claimed collateral, it is a compromise that  
9 can be presumed to have taken into account not only the subject  
10 property's value to each party, but also such factors as  
11 litigation costs avoided, expenses associated with delay, and the  
12 degree of risk posed by litigation. To any extent that the  
13 Settlement may be indicative of the collateral's value, it is  
14 certainly not dispositive of that issue and Alleghany has not  
15 established that Bank's payment of the amount called for by the  
16 Settlement constituted payment for the full value of the  
17 collateral, as opposed to payment in order to effect compromise of  
18 a controversy. As for whether Corporation's estate benefitted  
19 from Poonja's operation of the business, Alleghany argues that the  
20 business was operating at a monthly net loss of \$29,000 when  
21 Poonja took over but was operating at a monthly net gain of \$1,000  
22 when Bank foreclosed, so the estate benefitted from Poonja's  
23 efforts to the extent of at least \$90,000, which enabled Poonja to  
24 sell estate assets such as inventory and goodwill to Bank. Poonja  
25 replies that Alleghany's figures are drawn from the monthly  
26 operating reports filed by Corporation's estate and those were  
27 prepared on a "modified accrual" basis so as to be consistent with

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1 the method used by Corporation prior to Poonja's appointment as  
2 trustee; such basis did not account for monthly rent of \$72,000  
3 that was being accrued but not paid, and rent payments of even  
4 \$6,000 per month would have absorbed any apparent profit. Poonja  
5 also points out that his operation of the business could not have  
6 assisted the estate because there was no hope of reorganization,  
7 for the reasons set forth above. Poonja's operation of the  
8 business has not been shown to have been for the benefit of the  
9 estate, nor to have actually benefitted the estate rather than  
10 having benefitted Bank.

11 E. Reasonable and Necessary Charges

12 Expenses recoverable under §506(c) are limited to "the  
13 reasonable, necessary costs and expenses of preserving, or  
14 disposing of" the collateral sought to be surcharged. Alleghany  
15 argues that Poonja claims amounts that were not reasonable and  
16 necessary, for various reasons discussed below.

17 Poonja likens the services provided by him to those of  
18 receivers in State Court matters. Poonja contends that, if a  
19 Chapter 11 trustee had not been appointed, Bank's remedy would  
20 have been to seek appointment of a receiver in the State Court to  
21 run the business pending foreclosure, in order to preserve the  
22 going-concern value of the collateral -- however, Bank's receiver  
23 could not have taken charge of assets that were not Bank's  
24 collateral, such as receipts of the restaurant and lounge, or the  
25 liquor license needed to operate the lounge, or the accounts  
26 receivable and rents that were subject to the security interest of  
27

1 Comerica -- thanks to the appointment of a Chapter 11 trustee,  
Bank was not limited to the imperfect remedy of receivership and  
2 was instead able to avail itself of Poonja's services in operating  
3 the entire three-part business with the liquor license intact.  
4 Poonja provides a declaration by Randy Sugarman and one by Jerome  
5 Robertson, both of whom state that they are experienced receivers  
6 in State Court matters: the Sugarman declaration states that he  
7 charges \$300 per hour for his services, \$220 to \$250 per hour for  
8 the services of partners and principals in his firm, \$100 per hour  
9 for the services of financial analysts, and \$40 per hour for  
10 clerical services; the Robertson declaration states that he  
11 charges \$200 per hour for his services, \$125 per hour for the  
12 services of his associates, and \$85 per hour for clerical and  
13 accounting services; each declarant opines that a receivership of  
14 the type described by Poonja would be time-consuming and  
15 expensive, though neither has reviewed Poonja's itemized charges.  
16 Poonja also provides a declaration of himself, in which he states  
17 that he has served as a receiver in State Court matters and it is  
18 his opinion that operation of Corporation's business by a receiver  
19 would have cost at least as much as Poonja now seeks; he also  
20 points out that, in order to have a receiver appointed, Bank would  
21 have had to pay: 1) an attorney to file a complaint and move for  
22 appointment; 2) the cost of posting a receivership bond; 3) an  
23 attorney to represent the receiver; and 4) the receiver's fees and  
24 expenses. Poonja's itemized charges include \$250 per hour for his  
25 services and \$80 per hour for the services of an associate; they  
26 also include \$14,000 in rent payments attributable to the period  
27

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1 during which Poonja operated the business prior to Bank's  
foreclosure, based on a Court-approved compromise with trustee  
2 Richardson for rent owed by Corporation's estate to McFates'  
3 estate.

4 Alleghany complains that Poonja charges for overhead,  
5 including preparation of reports filed with the Court. Poonja  
6 points out that receivers in State Court matters charge, and are  
7 paid, for all services in connection with the receivership,  
8 including preparation of reports required by the State Court.  
9 Poonja's charges do not include specific items of overhead, such  
10 as his office rent or the like.

11 Alleghany notes that the recovery sought by Poonja exceeds  
12 that permitted by §326 governing compensation of bankruptcy  
13 trustees. Poonja correctly points out that §326 limits what  
14 bankruptcy trustees are permitted to charge estates, not what they  
15 are permitted to recover from others for estates, and it is the  
16 latter that Poonja seeks to do here. Poonja confirms that the  
17 recovery sought by these motions is for the benefit of  
18 Corporation's estate and not for Poonja's own personal benefit,  
19 noting that his trustee commission based on such recovery will be  
20 only the 3% rate provided by §326.

21 Alleghany takes issue with Poonja's charges of \$80 per hour  
22 for services provided by an associate, without explaining why such  
23 amount is too much. Poonja responds by stating the associate's  
24 qualifications and duties (most of which appear to have been  
25 clerical), and also points out that the Robertson declaration  
26 states an hourly rate of \$85 for "clerical" staff of a receiver.  
27

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1       This Court agrees with Poonja's analogy of his role in  
operating this business to that occupied by a State Court  
2 receiver, since it does appear that receivership would have been  
3 Bank's remedy in the absence of a trustee; Alleghany does not  
4 contend otherwise, or show that the analogy is inapposite. The  
5 declarations of Sugarman, Robertson, and Poonja are useful in  
6 determining the type and amount of reasonable and necessary  
7 charges incurred by receivers; Alleghany provides no evidence to  
8 the contrary. This Court has reviewed Poonja's charges and finds  
9 them both reasonable and necessary within the meaning of §506(c)  
10 under the facts of these cases.

11       Poonja also seeks to recover his attorney's fees and costs  
12 incurred to prosecute these motions (in an amount to be  
13 determined), citing In re Soucek, 50 B.R. 753 (N.D.Ill. 1985).  
14 That case does not address the issue, nor does this Court find any  
15 authority on point. Since §506(c) permits recovery only of  
16 expenses incurred to preserve or dispose of collateral, and only  
17 to the extent that such preservation or disposition benefits the  
18 holder of a lien upon such collateral, it is not readily apparent  
19 how the expense of seeking relief under §506(c) could be  
20 recoverable under that statute. Poonja has not demonstrated that  
21 he is entitled by §506(c) to recover from Alleghany his attorney's  
22 fees incurred to prosecute these motions.  
23

24  
25  
26                   III.

27                   CONCLUSION

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1 For the reasons hereinabove set forth:

2 Poonja's motions are granted in part and he is entitled  
3 to recover from Alleghany the sum of \$80,861.37 (\$65,520.80 for  
4 services plus \$15,340.57 for costs) pursuant to §506(c), as  
5 reasonable and necessary expenses incurred to preserve the  
6 collateral of Alleghany's predecessor; and

7 Poonja's motions are denied in part and he is not  
8 entitled to recover from Alleghany his attorney's fees and costs  
9 incurred to prosecute such motions; such denial is without  
10 prejudice to Poonja demonstrating entitlement to such recovery  
11 under §506(c).

12 Counsel for Poonja shall submit an order consistent with this  
13 Memorandum Decision, after review as to form by counsel for  
14 Alleghany.

15 Dated: September 3, 1999

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ARTHUR S. WEISSBRODT  
United States Bankruptcy Judge

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